

II. Prejudgment: Protecting the Government's Ability to Collect Taxes

A. Introduction: Preserving the Status Quo

The Tax Division plays an important role in the collection of revenue. We work with the IRS in collecting taxes, acting on the IRS's request for litigation assistance by way of suits to foreclose liens, fraudulent conveyance actions, failure to honor levy actions and suits to reduce assessments to judgment. These suits serve no useful purpose if they fail to bring tax revenue into the United States Treasury.

Yet litigation takes months, if not years, to progress to judgment. The trial attorney in the earliest stages of collection litigation should identify clearly the collection goal to be accomplished. If specific assets are to be the subject of the litigation, make sure that the assets will retain their value until the time when judgment is obtained. The ability to collect most judgments also depends upon the Government's retention of its priority position as to the judgment debtor's assets. This section of the Manual describes some of the tools available to us before judgment is entered to preserve assets and to obtain and preserve priority against competing claimants.

Generally when the IRS requests the Tax Division to initiate a collection suit (such as a suit to reduce assessments to judgment, a counterclaim, or a foreclosure action) and the IRS is aware of assets which may be easily dissipated or moved beyond the Government's reach, the IRS will request that the Tax Division initiate litigation to preserve the status quo. On occasion, however, a Tax Division trial attorney may learn of the existence of a fraudulent conveyance that was not known to the IRS. In that case the trial attorney, after consulting with the section chief, should request the IRS to consider filing a nominee lien and should seek the IRS's views as to whether the Tax Division should file suit to set aside the fraudulent conveyance.

B. The Importance of the Notice of Federal Tax Lien

A taxpayer who is delinquent in paying taxes frequently has other financial problems. The IRS can protect its claim against those of competing creditors by seizing assets and filing notices of federal tax liens. The IRS does an excellent job in filing notices of federal tax liens because its representatives recognize that its collection goals can be frustrated by losing priority battles with competing creditors.

The trial attorney should ensure that notices of federal tax liens have been filed and, if they have not, request the IRS to file them.² When we are reducing an assessment to judgment, either by way of counterclaim in a refund suit involving a divisible assessment (such as a 100% penalty suit), or in a collection suit initiated by the United States as plaintiff, notices of federal tax liens should be filed. If real property is located in a county other than that in which the debtor resides, the trial attorney should ensure that a notice of federal tax lien has also been filed in that jurisdiction.

When bringing a suit to set aside a fraudulent conveyance or to determine that real property is held by a nominee or alter ego of the taxpayer, the trial attorney should ensure that the IRS has filed a nominee lien notice, which serves to prevent the title holder of the property from transferring the property beyond the Government's reach and also preserves the Government's priority position. Another way to prevent such a transfer is to file a notice of lis pendens after the complaint has been filed.

C. Injunctions and Receiverships

A broad range of injunction and receivership actions is available pursuant to §§ 7402(a) and 7403 of the I.R.C. to preserve a taxpayer's assets for collection. Where necessary, the Government can seek a temporary restraining order and preliminary injunction to preserve assets while litigating the merits of a permanent injunction. Further, 28 U.S.C. § 3103 authorizes the appointment of a receiver in certain circumstances.

A § 7402(a) injunction may be used to freeze assets both inside and outside of the United States. United States v. First Nat'l City Bank, 379 U.S. 378 (1965) (New York bank enjoined from transferring taxpayer's funds at branch offices within or without the United States); United States v. McNulty, 446 F. Supp. 90 (N.D. Cal. 1978) (taxpayer directed to repatriate Irish Sweepstakes winnings from the English Channel Island of Jersey and deposit them with the clerk of court). A writ of ne exeat republica may issue pursuant to § 7402(a) restraining a taxpayer from leaving the United States, thus frustrating the expatriation

² A discussion of the federal tax lien, how and when it arises, and the significance of the notice of federal tax lien is contained on pp. 31-33, infra.

³ See discussion of lis pendens, pp. 6-7, infra.

of the taxpayer's assets. United States v. Lipper, 81-1 U.S. Tax Cas. (CCH) ¶ 9330 (N.D. Cal. 1981). But see, e.g., United States v. Shaheen, 445 F.2d 6 (7th Cir. 1971). Furthermore, a receiver may be appointed pursuant to § 7402(a) or § 7403 to prevent transfers and concealment of taxpayer's property (cf. Florida v. United States, 285 F.2d 596 (8th Cir. 1960)) or the waste or dissipation of taxpayer's assets (United States v. Peelle Co., 224 F.2d 667 (2d Cir. 1955); Goldfine v. United States, 300 F.2d 260 (1st Cir. 1962)). Where a receiver has been appointed, a court may order the taxpayer to turn stock certificates over to the receiver. Florida v. United States; United States v. Ross, 302 F.2d 831 (2d Cir. 1962) (stock of foreign corporation not doing business in the United States).

D. Lis Pendens

In suits involving real property, the trial attorney should file a notice of lis pendens (pending litigation) promptly after the filing of the complaint. Without a notice of lis pendens (or notice of tax lien or nominee lien) the current record owner of the property may be able to transfer the property or mortgage it, possibly giving the transferee or mortgagee a claim prior to that of the Government.

The doctrine of lis pendens exists at common law and under some state statutes. The doctrine holds that whoever purchases or acquires an interest in property that is the subject of pending litigation stands in the same position as the seller, is charged with notice of the rights of the seller's adversary, and takes the property subject to whatever valid judgment is entered in the litigation. 51 Am. Jur. 2d. Lis Pendens, § 1 et. seq. (1970 & 1991 Cum. Supp.). Under many state statutes, however, in order to obtain the protection provided by this doctrine, a formal notice of lis pendens must be filed in the manner described. Section 1964, 28 U.S.C., provides that where state law requires the filing of a notice of lis pendens, state law must be complied with in order to give constructive notice of such an action pending in a United States District Court as it relates to real property in the state. See generally, 51 Am. Jur. 2d Lis Pendens. Accordingly, the form for a notice of lis pendens in a particular case and the manner in which the form is filed are specified by the law of the state where the property is located. An Assistant United States Attorney who handles collection matters or a fellow trial attorney who is familiar with the procedures of the state are good sources for ascertaining, without extensive research, the correct form and method of filing a notice of lis pendens for a particular state.

The filing of a notice of lis pendens is essential when

notice of federal tax liens cannot be or have not been filed-- for example, where we have brought a fraudulent conveyance action but no nominee lien is on file. Where there is some question whether a nominee lien is effective, a lis pendens should always be filed. The notice cannot be filed until the complaint is filed, but the notice should be filed if at all possible on the same day or within one or two days of the filing of the complaint to ensure that the notice is filed before the complaint is served on the record owner of the land.

E. Prejudgment Remedies Under the
Federal Debt Collection Procedures Act

In addition to prejudgment remedies available under the I.R.C., the Federal Debt Collection Procedures Act provides expressly for prejudgment remedies, such as attachment, receivership, garnishment and sequestration. Under 28 U.S.C. § 3101, the United States may, in a proceeding in conjunction with a complaint or at any time after the filing of a civil action on a claim for a debt, make application under oath to a court to issue any of the prejudgment remedies provided in 28 U.S.C. §§ 3102 through 3105. The usual grounds for a prejudgment remedy are that, with the effect of hindering, delaying or defrauding the United States, the debtor is about to leave the United States, has or is about to conceal or destroy property, has or is about to convert property into money or securities to the prejudice of the United States, or has evaded service of process or temporarily left the United States. Another potential basis for obtaining a prejudgment remedy is that the prejudgment remedy is required to obtain jurisdiction within the United States and the prejudgment remedy sought will result in obtaining such jurisdiction. Prejudgment remedies require notice to the debtor and any person believed to have possession or control of property subject to the remedy. The specific procedures applicable are contained in §§ 3102 (attachment), 3103 (receivership), 3104 (garnishment) and 3105 (sequestration).

If the taxes and statutory additions involved in a collection suit exceed \$50,000 and the United States applies for a prejudgment remedy under 28 U.S.C. §§ 3101 through 3105, the United States may conduct prejudgment discovery regarding the taxpayer's financial condition in the manner in which post-judgment discovery is authorized by 28 U.S.C. § 3015(a) and Fed. R. Civ. P. 69. See 28 U.S.C. § 3015(b).

F. Administrative Collection While
 Litigation is Pending: Pros and Cons

While litigation, such as a suit to reduce an assessment to judgment, is pending, IRS collection activity generally should continue. In refund litigation concerning divisible assessments (such as trust fund recovery penalty or excise tax assessments), however, where the taxpayer has made a partial payment and the United States has counterclaimed for the balance owed, the Internal Revenue Manual provides that the IRS will not institute collection activity while the matter is in litigation unless collection of the tax appears to be in jeopardy. 1 Administration, CCH Internal Revenue Manual, ¶ P-5-16, at 1305-11. Legally, there is nothing to prevent the IRS from collecting the taxes assessed.

G. Preparing for Collection by
 Obtaining Copies of Tax Returns

If a case involves a collection suit (e.g., a suit to reduce assessments to judgment or a counterclaim), the trial attorney should consider obtaining copies of the taxpayer's income tax returns for all years commencing with the first year in suit or for some shorter period to determine sources of collection. In evaluating whether to request returns at the outset of the litigation, the trial attorney should keep in mind that the tax returns may be destroyed by the IRS by the time the litigation is concluded. Income tax returns should routinely be obtained in any case where the liability is substantial (more than \$25,000). Requests to the IRS for income tax returns should be made in writing to the District Counsel or by telephone to the Service Center, followed by a confirming letter, a copy of which is to be stamped "Received" and returned immediately to the Tax Division. The Service Center personnel have been instructed to call for such confirmation if they have not received it within five days of the telephone request. Attached as Exhibit 1 is a form of letter which may be used for this purpose, and attached as Exhibit 2 is a list of the Service Centers with the names and telephone numbers of the contacts at each Center.